ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author:	Poochigian	Analyst:	LuAnna Hass	Bill Number:	SB 718
Related Bills:	See Legislative History	Telephone:	845-7478	Introduced Date:	02-23-2001
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Used Oil Recycling Equipment Credit

SUMMARY

This bill allows a credit for the cost of equipment purchased to recycle used motor oil.

This analysis will not address the bill's provision appropriating funds for the Waste Management Board as it does not impact the department or state income tax revenues.

PURPOSE OF THE BILL

According to the author’s office, the purpose of this bill is to encourage recycling of oil because previously refined oil requires much less energy to refine than is needed to refine crude oil.

EFFECTIVE/OPERATIVE DATE

This bill contains appropriations language and would be effective and operative for taxable years beginning on or after January 1, 2002.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAWS

Existing state and federal laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

Board Position:			Department Director	Date
____ S	____ NA	____ NP	Alan Hunter for GHG	04/03/01
____ SA	____ O	____ NAR		
____ N	____ OUA	__X__ PENDING		

A depreciation deduction is generally allowed under federal and state law for the obsolescence or wear and tear of investment property or property used in a business. The amount of this deduction is determined, in part, by the cost (or basis) of the property. In addition, the property must have a limited, useful life of more than one year. Depreciable property includes equipment, machinery, vehicles, and buildings, but excludes land. Significant improvements to property increase the basis of the property and are depreciated over the property's remaining useful life.

Currently, federal and state laws offer various tax incentives relating to oil. These incentives include an enhanced oil recovery credit, depreciation deductions for assets used to explore, drill or refine oil, and a depletion deduction for oil wells.

THIS BILL

This bill would allow taxpayers a credit equal to 35% of the cost paid or incurred for purchasing any equipment that is utilized to recycle used motor oil. Any unused credit may be carried forward indefinitely.

IMPLEMENTATION CONSIDERATIONS

This bill uses terms and phrases that are undefined, i.e., “equipment used to recycle” and “used motor oil.” The absence of definitions to clarify these terms could lead to disputes between taxpayers and the department and would complicate the administration of the credit. The author may want to make reference to provisions of the Health and Safety Code that define similar terms such as used oil, recycled oil, and used oil-recycling facility.

The department does not have the expertise to verify whether equipment a taxpayer purchased is utilized for recycling used motor oil and would therefore be eligible for the credit. The author may consider requiring the proper local authority or a state agency to certify that the equipment purchased is sufficient to recycle used motor oil and is eligible for the credit. The author may also consider requiring the taxpayer to obtain, retain, and provide evidence of this certification to the department upon request. The taxpayer should be required to obtain this certification as a pre-condition to claiming the credit under this bill.

OTHER STATES’ INFORMATION

Review of Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York laws found no comparable tax credits or deductions. These states were reviewed because of the similarities between California income tax laws and their tax laws.

FISCAL IMPACT

If this bill were amended to resolve the implementation considerations addressed in this analysis, the bill would not impact the department’s costs.

ECONOMIC IMPACT

TAX REVENUE ESTIMATE

As currently drafted, this bill could result in significant revenue losses under the Personal Income Tax and the Bank and Corporation Tax Laws, easily on the order of $10 million annually.

Levels of annual purchases of equipment utilized for any phase of recycling used motor oil are unknown. As currently drafted, the bill is extremely broad in possible application and does not limit purchases to California only. Investment in equipment can vary significantly depending up on a taxpayer's role in the recycling process. Costs for equipment can range from as little as $100 for a 55-gallon drum used as a storage container at a collection site to perhaps $10 million or more for construction of a re-refining facility of an appropriate capacity for used oil.

ARGUMENTS/POLICY CONCERNS

This bill does not restrict the credit to taxpayers that purchase equipment to be used within this state.

This bill allows the credit in the taxable year in which the equipment is purchased, which may be earlier than the taxable year in which the equipment is actually placed in service (i.e., used) in California. Most credits involving the acquisition and subsequent use of an item of property allow the credit to be claimed in the taxable year in which the placed in service date, for depreciation purposes, occurs. It is possible that a taxpayer could purchase the equipment, claim the credit, and resell the equipment to a third party that may also claim the credit. If this bill were to require that the equipment be placed in service in California, with an appropriate recapture provision to ensure continued operation in California, this potential problem would be avoided. The recapture provision would require the taxpayer to use the equipment for a certain length of time in this state or add all or some portion of the credit amount back to the tax liability.

This bill does not specify a repeal date or limit the number of years for the carryover period. Credits typically are enacted with a repeal date to allow the Legislature to review their effectiveness. However, even if a repeal date were added, the department would be required to retain the credit on the tax forms indefinitely because unlimited credit carryover period is allowed. Recent credits have been enacted with a carryover period limitation since experience shows credits are typically used within eight years of being earned.

Additionally, conflicting tax policies come into play whenever a credit is provided for an item that is already deductible as a business expense or is depreciable. Providing both a credit and allowing the full amount to be deducted would have the effect of providing a double benefit for that item. On the other hand, making an adjustment to reduce basis in order to eliminate the double benefit creates a difference between state and federal taxable income, which is contrary to the state's general federal conformity policy.

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